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No. 01-1435

In the

Supreme Court of the United States

CLACKAMAS GASTROENTEROLOGY ASSOCIATES, P.C.,

Petitioner,

v.

DEBORAH ANNE WELLS,

Respondent.

ON A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

REPLY BRIEF FOR PETITIONER

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ARGUMENT

I. COURTS SHOULD APPLY THE EEOC GUIDANCE FACTORS TO DETERMINE WHETHER THE SHAREHOLDERS/DIRECTORS OF A PROFESSIONAL CORPORATION ARE EMPLOYEES UNDER THE ADA.

The EEOC guidance provides a straightforward framework for analyzing both whether partners, in reality, should be considered employees under the ADA and whether shareholders of a professional corporation, in reality, should be considered partners ("EEOC Br." at 8 and 9)[1] ("EEOC Guidance"). Courts should consider the economic realities of the circumstances using the factors embodied in the EEOC Guidance.

Four different approaches to the question presented in this case have been proposed:

1. The EEOC Guidance, which the Petitioner ("Clinic") supports;
2. The "analytical model," which the Respondent ("Wells") supports, Resp. Br. at 34;
3. The "common law test," which *Amicus* AFL-CIO supports, AFL-CIO Br. at 7; and

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[1] The Respondent's and *amici* briefs are referenced as follows: Brief of Respondent ("Resp. Br."); Brief for the United States and the Equal Employment Opportunity Commission ("EEOC Br."); Brief for the Lawyers' Committee for Civil Rights Under Law, et al. ("Lawyers' Committee Br."); and Brief of the American Federation of Labor and Congress of Industrial Organizations ("AFL-CIO Br.").

4. The "*Trainor*" test, which *Amicus* Lawyers' Committee supports, Lawyers' Committee Br. at 14.

The best approach is offered by the EEOC Guidance. The approach of the EEOC Guidance is similar to the approach adopted by this Court in *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318 (1992), except that the EEOC uses factors that go to the heart of the distinction between shareholder/directors and employees. The alternative approaches supported by Wells and *amici* share a common shortfall: each takes too narrow a slice of business reality to accommodate the complexities of modern American business.

A. Advantages of the EEOC Guidance

The EEOC Guidance promotes the purposes of the ADA. When Congress adopted the ADA, one of its purposes was to cover larger, not smaller, employers. Large and small employers are not divided by gross or net income, but rather by the number of employees in an enterprise. This makes sense because personnel policies and procedures, including policies designed for ADA compliance, impact people, not income. At least one of the EEOC's Guidance factors addresses this issue head on:

> Whether an organization can hire or fire the individual or *set the rules and regulations of the individual's work*, EEOC Compl. Man. (BNA) §2 at 605:0009 (2002)(emphasis supplied).

"Rules and regulations" are personnel policies. Business entities generally adopt personnel policies to regulate employees' compensation, benefits, hours of work, work assignments, and the like. See e.g. EMPLOYMENT COORDINATOR, ¶ PM 11.061 at 141.051 (West Group, et al. eds., 2002). If, under the EEOC's Guidance factor relating to "rules and regulations," an individual is found to operate independently of the entity's personnel policies, he is less like an employee and more like a proprietor or partner. For example, an individual whose compensation is based on a percentage of net profits, and who selects and pays for his own retirement plan is, in reality, more like a proprietor or partner than an hourly worker whose retirement is her employer's contribution to its retirement plan. Application of the EEOC Guidance, therefore, identifies the individuals who really ought to be covered, regardless of their label. Counting only individuals who are subject to the rules and regulations of the business promotes the objectives of the Act by sparing smaller businesses that are ill-equipped to comply with the ADA, and by giving individuals who are subject to the rules and regulations the right to sue. This is fair both to proprietors and to those who need the ADA's protection.

The EEOC Guidance provides consistency. Businesses that are similarly situated should be treated alike. Two identical clinics which operate exactly the same, differing only in structure, should be treated alike under the ADA. The differences between a professional corporation and a limited liability partnership, for example, are not the kind of differences which impact people; those differences primarily impact how the entities are taxed. The EEOC Guidance looks beyond the label affixed to the business structure at the actual operational realities of the business. That is, it looks to

substance over form. As a result, application of the EEOC Guidance factors consistently treats similarly situated businesses alike.

The EEOC Guidance is workable without being rigid. The EEOC Guidance factors address issues which American businesses deal with day-to-day. Proprietors, managers, supervisors, and employees are perfectly comfortable dealing with issues targeted by the EEOC Guidance, such as who in the organization can hire or fire, who supervises and assigns work, what is the chain of command, and who shares the opportunity for profits and risks of losses of the business. These are factors crafted in terms that individuals involved in the operation of businesses can understand and apply. Similarly, courts and practitioners benefit from a checklist with some objective factors (such as the existence of written employment agreements and participation in profits and losses) and some subjective factors which can be supported or refuted by unambiguous evidence (such as reporting requirements in a personnel flow chart and management authority as set forth in personnel policies).

B. Disadvantages of the Alternative Approaches

1. The "Analytical Model"

The alternative approaches supported by Wells and *amici* take too limited a segment of reality to yield satisfactory results. The "analytical model" supported by Wells examines two factors: the form of business structure and whether, in the case of a professional corporation ("PC"), the shareholders performed traditional employee duties (Resp. Br. at 34). For

professionals in a professional corporation, the answer to the second inquiry in Wells' "analytical model" is always the same: professional shareholders always perform traditional employee duties since they provide the professional services for the clients or patients. Therefore, Wells' analytical model actually looks only to the form of the business structure, an approach that yields inconsistent results for similarly situated businesses and fails to advance the purpose of the ADA.

The "analytical model" applies one test for an individual's right to sue and another test for coverage. This "analytical model" should be rejected for two reasons. First, applying different tests may yield inconsistent results. For example, an individual could find himself an employee for purposes of coverage, but with no right to sue. Second, Wells does not make any attempt to identify anything in the language of the ADA which justifies this bifurcated approach, except the claim that it promotes the remedial purpose of the Act. Resp. Br. at 27. This reasoning was abandoned by this Court in *Darden*, (Citing *Community for Creative Non-Violence v. Reid*, 490 U.S. 730 (1989)). (*Reid* signaled abandonment of previous emphasis on construing the term 'employee' "in light of the mischief to be corrected and the end to be obtained," *Darden* at 325.) Courts should apply the same test whether the issue is coverage of the ADA or an individual's right to sue.

2. The "Common Law Test"

The "common law test" supported by the AFL-CIO suggests that courts should look to the general common law of Agency found in the RESTATEMENT (SECOND) OF AGENCY. However, the RESTATEMENT does not provide definitive guidance for determining whether

partners, in reality, should be considered employees, and whether shareholders of a professional corporation should be, in reality, considered partners.

The "common law test" relies on the suggestion that the term "employee" in the ADA is synonymous with the RESTATEMENT'S definition of "servant." AFL-CIO Br. at 6. However, that theory fails for two reasons. First, even though a partner is not an employee, the RESTATEMENT acknowledges that a partner who is active in the management or regularly employed in the business of the partnership is a servant of the partnership, RESTATEMENT (SECOND) OF AGENCY §14A at 62 (1958). Such a partner is therefore a servant, but not an employee. Similarly, shareholders of a professional corporation could, and likely would be, servants of the P.C., but still not be employees. Second, it is difficult to imagine a circumstance where a professional partner would not qualify as an employee under the RESTATEMENT test. After all, any doctor, attorney, or accountant, whether in a partnership, a limited liability company ("LLC") or a professional corporation meets the RESTATEMENT definition of employee since she is, on a regular and continuing basis, performing "service in [the enterprises'] affairs" which are controlled or subject to control, at least in some respects, by her colleagues, regardless of the business structure. *Id.* §2(1) at 12. For example, the four physicians in the Clinic are subject to peer review, a form of quality control for patient care. That control or right to control meets the RESTATEMENT test, whether or not the physicians are partners in a partnership or shareholder/directors of a professional corporation.

It is true that in *Darden*, this Court found that the term "employee" should be construed to incorporate traditional agency law principles. *Darden* at 323. Here, however, unlike the distinction between an employee and an independent contractor examined in *Darden*, the distinction between an employee and a shareholder/director of a professional corporation has not accumulated a settled meaning at common law.

3. The "*Trainor*" Test

The "*Trainor*" test fairs no better for similar reasons. The court in *Trainor v. Apollo Metal Specialties, Inc.*, No. 01-5077, 2002 U.S. App. LEXIS 25654 (10th Cir. December 13, 2002) analyzed whether a shareholder/director of a general corporation was, in reality, an employee. There are two reasons why the "*Trainor*" test is not appropriate here. First, the *Trainor* court noted that "courts have distinguished between professional corporations and traditional corporations" on this issue, and that court refused to apply the same test to both. *Trainor* at 7. Second, the *Trainor* court applied a three factor test, which, if applied to a professional partner, would virtually always result in the professional partner being designated an employee. That is, the "*Trainor*" test results in the illogical outcome of professionals being regarded as employees even if they were sole proprietors or partners.

The factors contained in the EEOC guidelines provide a workable framework for analyzing economic realities to determine whether partners are, in reality, employees, and whether shareholders of a professional corporation are, in reality, partners.

II. COURTS SHOULD EXAMINE FACTORS BEYOND THE FORM OF THE BUSINESS ENTITY.

Courts should look beyond the business structure of an entity to ascertain whether that entity is an employer covered by the ADA. The ADA does not differentiate among business structures. Since World War II, American business structures have been evolving from the traditional dichotomy between general partnerships and ordinary corporations to business structures that adopt significant features of both. See PHILIP P. WHYNOTT, THE LIMITED LIABILITY COMPANY §1.60 (Thomas W. Overton ed., 3d ed. 2002). The law needs to remain nimble enough to deal with this evolution. It cannot remain a slave to labels, because those labels no longer clearly identify the economic realities of the business structure.

Wells maintains that, since the Clinic voluntarily adopted the professional corporation structure, this Court should not look beyond that structure at other factors. Resp. Br. at 22. In support of her position, Wells suggests that the Clinic could have selected a number of other forms of business structure. Resp. Br. at 23. However, at the time the Clinic was formed as a professional corporation in 1979[2], the only alternative form of business structure available to professionals was a general partnership. But, as a partnership, the Clinic was not allowed the benefits of either limited liability or a retirement plan like a corporation.

[2] The Clinic has lodged 12 copies of its original Articles of Incorporation with the Court.

It is fundamentally unfair to hold the Clinic's physicians to a different standard under the ADA just because they formed their business in 1979, prior to the adoption of statutes which would have allowed it to become a limited liability partnership ("LLP"). Beginning in the 1980's, Oregon (and most other states) adopted statutes which allow professionals to operate as LLPs and LLCs. WHYNOTT, *supra* at §1:40. Today, professionals like the four physicians in this Clinic, may adopt the LLP form of organization and obtain the same retirement plan and liability benefits as they would as a PC. And, the professionals in the LLP would not be considered employees for purposes of ADA coverage. Further, the Clinic is saddled with being a PC indefinitely. The Clinic cannot convert to an LLP without catastrophic financial consequences, since that conversion would be a taxable event under 26 U.S.C. §331(a)(2001).

Wells' claim that the Clinic has somehow obtained "the best of both worlds" is misleading. This argument implies an improper purpose on the part of the Clinic. However, Wells does not, and cannot, argue that the Clinic elected to exist as a professional corporation in order to avoid the coverage of the ADA. The Clinic was formed as a professional corporation in 1979, 11 years before the ADA was adopted. In reality, the PC is, in many respects, the poor stepchild of the ordinary corporation. Professional corporations cannot make private or public offerings of their stock to obtain capital. Professional corporation shareholders do not enjoy the same full limitation on liability as shareholders in a regular corporation; yet, a PC is taxed as a personal service corporation, 26 U.S.C. §441(i)(2)(2001) (at a higher rate than an ordinary corporation); and the shareholders are subject to tax on their dividends,

subjecting the owners to double taxation. 26 U.S.C. §301(2001).[3] On the other hand, partners in LLPs and members of LLCs enjoy the same limited liability as PC shareholders, but are taxed as partners without double taxation. Professional corporations are burdened with the same record keeping requirements and tax obligations as ordinary corporations, but do not obtain any better tax advantages as their colleagues in LLPs and LLCs.

CONCLUSION

The judgment of the Court of Appeals should be reversed.

Respectfully submitted,

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[3] It is common practice for a professional corporation to pay bonuses to its shareholder-employees in amounts sufficient to reduce the corporation's taxable income to zero. However, issues may arise regarding these amounts being subject to recharacterization by the Internal Revenue Service as dividends under an unreasonable-compensation argument. See *Pediatric Surgical Associates, P.C.*, TC Memo 2001-81, and Alson R. Martin and Morton A. Harris, *Unreasonable Compensation*: Pediatric Surgical *Poses a Major New Threat for PCs*, 97 J. TAX'N 41 (2002).